Internal Revenue Service

memorandum

CC:EL:GL:BR3;CCAMPBELL\CC:DOM:IT&A:BR4;NROMANO
GL-0186-96

date: SEP 27 1996

to: Assistant Commissioner (Submission Processing) T:S

from: Assistant Chief Counsel (IT&A) CC:DOM:IT&A
Assistant Chief Counsel (GL) CC:EL:GL

subject: Direct Deposit of Tax Refunds

This memorandum responds to your March 22, 1996, inquiry concerning the direct deposit of tax refunds into joint bank accounts.

FACTS

As "direct deposit" banking becomes more popular, more taxpayers are requesting that the Service deposit their refunds directly into their bank accounts. Current Service policy limits direct deposit of refunds to certain accounts. Several taxpayers have questioned the policy.

Current Service direct deposit policy distinguishes between married and individual filers. Presently, married taxpayers electing "married filing jointly" status may designate that their tax refund be deposited into either spouse's individual bank account or into a spousal joint bank account. A married taxpayer electing "married filing separate return" status may designate that his/her refund be deposited into a joint bank account owned with his/her spouse or into the taxpayer's individual account. The Service offers all other filers only one option, i.e., deposit into a taxpayer's individual bank account. These taxpayers do not have the option of depositing their tax refunds into any joint account including a spousal joint account. See Form 8888, Direct Deposit of Refund. It is our understanding that the Service does not have the ability to verify the ownership of the account receiving a direct deposit tax refund.

Recently, some taxpayers have criticized the Service's policy of not permitting an individual taxpayer to deposit his/her tax refund into a joint account with an individual who is not the taxpayer's spouse. These critics think that the policy is discriminatory and inconvenient. However, some banks have noted increased disputes between spousal joint depositors and have asked the Service about their liability if a spouse claims that he/she never had access to a portion of a federal tax refund that was deposited into a spousal joint bank account.

Presumably, disputes would increase if nonspouses had access to individual refunds deposited into joint bank accounts.

ISSUE

Whether the Service may pay a refund to a taxpayer(s) by depositing the refund into a joint bank account "owned" by the taxpayer(s) and other parties not entitled to the refund.

CONCLUSION

Section 6402 of the Internal Revenue Code directs the Service to pay refunds to only the taxpayer(s) owed the refund, i.e., the owner(s) of the claim for refund. In some states, creating a joint bank account with right of survivorship vests each account signatory with full ownership of all money deposited in the account. In other states, creating a joint bank account with right of survivorship does not automatically vest each account signatory with full ownership. Because state law and bank depository agreements vary so widely, the Service could not evaluate the ownership question for each directly deposited refund. To avoid potential section 6402 challenges completely, the Service should not pay refunds by depositing individually owned refunds into joint accounts with signatories not entitled to the refund.

Further, depositing a taxpayer's refund into certain joint accounts could transfer the taxpayer's interest in the refund claim against the government to account signatories not entitled to the refund. Such a transfer would be an ineffective assignment under the Assignment of Claims Act.

DISCUSSION

The Commissioner's Obligations in Determining an Overpayment

The Commissioner has the authority to credit the amount of an overpayment against any internal revenue tax liability of the "person who made the overpayment" and "refund any balance to such person." See section 6402(a) of the Code. Pursuant to section 6402 of the Code, the Service is required to determine whether an overpayment exists in order to process the claim. If an overpayment exists, the Service is required to refund the overpayment, in excess of any outstanding internal revenue tax liability, to the taxpayer. See section 301.6402-2(f) of the Regulations on Procedure and Administration. However, before the determined overpayment is refunded to the taxpayer, the Commissioner is required to offset any refund by past due child support, debts owed to federal agencies, and for overpayment of

Old Age Survivors and Disability Insurance.[1] See sections 6402(c) and (d) of the Code.

As a general rule, a claim for the credit or refund of an overpayment in income tax must be made on the return (or amended return) filed for the tax year. A return qualifies as a claim for refund if it sets forth the amount of the overpayment and provides directions as to its refund or application. See section 301.6402-3(a)(5) of the regulations. Claims for refund must be filed with the service center serving the internal revenue district in which the tax was paid. See section 301.6402-2(a)(2) of the regulations. Once a claim for refund is received by the Service, service center personnel scrutinize the claim for completeness, validity, and timely filing. Service personnel determine whether the claim involves audit matters or should be processed at the service center. See IRM 4511 (Centralized Classification of Claims) and IRM 4512 (Preliminary Examination & Disposition of Claims Referred to Examination).

Once the Service has rejected a claim for refund, there is no longer a claim pending before the Service. Allstate Insurance v. United States, 550 F.2d 629 (Ct. Cl. 1977). At that time, the taxpayer has the option of filing a refund suit in either a federal district court or the United States Court of Federal Claims. See sections 7422 and 6532(a) of the Code.

The Commissioner's Obligation to Pay the Refund to its Owner

1. Refund Claim "Owners"

Section 6402(a) directs the Commissioner to (1) credit the amount of any overpayment against the tax liability of the "person who made the overpayment" and (2) "refund any balance to such person." That is, section 6402(a) requires the Service to pay the refund to the owner of the claim for refund.

The Code generally imposes individual and organizational tax liability. Only individual tax liability is at issue here. Filing status defines individual tax liabilities. Sections 2 and 7703 of the Code define five filing statuses for individuals: one joint (and several) liability for spouses "married filing jointly;" and four strictly individual liabilities, i.e., single, head of household, qualifying widow(er) with dependent child, and married filing separate return. Ownership of the claim for refund follows the overpayment of the tax liability.

---

[1] Special rules exist for the offset of tax refunds in certain bankruptcy situations. See 11 U.S.C § 362(a) and (d).

2. Form of Payment

Historically, the Service has paid refunds directly to the owner(s) of the claim by check made payable only to the owner(s). In the paper check payment context, the owner/payee(s) was easy to identify. Section 301.6402-2(f) of the regulations provides that checks in payment of claims allowed will be drawn in the names of the persons entitled to the money; and, the checks may be sent directly to the claimant or to such person in care of an attorney or agent pursuant to a power of attorney[2] specifically authorizing the designated attorney or agent to receive such checks. However, an attorney or agent authorized to receive the check on behalf of the taxpayer owning the refund may not negotiate the check unless this authority is specifically granted. See section 601.504(a)(5) of the regulations; see also, 31 C.F.R. §240.15. In fact, a return preparer who endorses or otherwise negotiates (either directly or through an agent) a refund check issued to a taxpayer is liable to pay a $500 penalty with respect to each check. See section 6695(f) of the Code. Other government agencies' payment practices may vary because they are not subject to section 6402.

In the electronic "direct deposit" context, payment of the refund is (ironically) less direct. Instead of paying the refund by negotiable check directly to the owner, the Service orders a transfer of funds to a bank for deposit into the taxpayer's account. If the account is owned solely by the owner(s) of the refund claim, there is little question that deposit constitutes payment solely to the owner(s) of the claim within the intent of section 6402(a). However, if the account is owned jointly by the owner(s) of the refund and parties not entitled to the refund, the payment by deposit may constitute payment in violation of section 6402(a). The question turns on state law and bank deposit agreements governing ownership in the account.

3. Account Ownership

State banking law and banking agreements vary widely. The label of an account is often not dispositive: all joint accounts do not vest the account signatories with full ownership in the contents of the account.

---

[2] See § 601.504(a)(5) of the Regulations on Procedure and Administration (requiring power of attorney to receive another's check drawn on the United States Treasury); see also § 601.502(a) of the Regulations on Procedure and Administration (describing qualifications of individuals qualified to represent a taxpayer).

In some states, creating a joint bank account with right of survivorship presumptively vests each account signatory with full ownership of all the money deposited in the account. See Desrosiers v. Germain, 429 N.E.2d 385 (Mass. App. 1982) (transaction of creating a joint bank account must be construed literally, unless the evidence shows the parties did not so intend). Arguably, if the Service pays a refund by depositing an individual's refund directly into such a joint bank account with a signatory who is not entitled to the refund, the Service will have paid the owner's refund to both the owner and a nonowner. The owner could then challenge the Service's payment as a violation of section 6402.

In other states, creating a joint bank account with right of survivorship does not presumptively vest each account signatory with full ownership. See Chopin v. Interfirst Bank Dallas NA, 694 S.W. 2d 79 (Tex. App. 5 Dist. 1985)(title of joint account does not determine "ownership" of the account, even if the account holders are entitled to possession of the funds). Arguably, if the Service deposits an individual's refund directly into such a joint bank account, the Service will not necessarily have paid the owner's refund to the signatory not entitled to the refund. The owner might challenge the payment as a violation of section 6402; and the claim would turn on state banking law.

Because state law and bank depository agreements vary so widely, the Service could not evaluate the ownership question for each directly deposited refund. To avoid potential section 6402 challenges completely, the Service should not pay refunds by depositing individually owned refunds into joint accounts with signatories not entitled to the refund. Only taxpayers "married filing jointly" are jointly entitled to their refunds. All other filers are entitled only to their individual refunds.

If the Service chooses to honor taxpayer requests to deposit individually owned refunds into joint accounts with other signatories, despite the risk of section 6402 challenges, the Service should prominently disclaim liability for improper payment. The direct deposit request form should state clearly that the Service will treat deposit into a joint account at a taxpayer's request as payment solely to the taxpayer. Such notice to taxpayers would enhance the Service's ability to defend a section 6402 challenge, but not guarantee ultimate success.

The Assignment of Claims Act

A taxpayer's request to have the Service "direct deposit" a refund into a joint bank account also raises an assignment issue. The question is whether the deposit into the joint account constitutes a transfer of the taxpayer's interest in the refund to an account signatory not entitled to the refund under section

6402. Such a transfer would be an assignment of the taxpayer's claim.

The Assignment of Claims Act (the Act), 31 U.S.C. §3727, limits the ability of parties to bind the government to assignments of claims against the government. The Act sets the conditions for effectively assigning a claim against the government. Unless these conditions are met, the government is not bound to honor or respect an assignment of a claim. Specifically, the Act provides that an assignment of a claim against the government is effective only after the claim is allowed, the amount of the claim has been determined, and a warrant (i.e., a check) for the payment of the claim has been issued. The Act also provides that the assignment must be made voluntarily, must be attested to by two witnesses and must be certified. See 31 U.S.C. § 3727(b). Assigned claims which do not meet these conditions cannot be enforced against the government. United States v. Shannon, 342 U.S. 288 (1952).

The purpose of the Act is to protect the government from possible multiple payment of claims, to prevent unnecessary investigation of alleged assignments, to allow the government to deal with only the original claimant, to preserve any set-off defenses or cross-claims that could be brought against the original claimant, but not the assignee, and to prevent the general purchase of claims against the government that may later be improperly urged upon officers of the government. See United States v. Shannon, 342 U.S. 288 (1952); United States v. Aetna Surety Co., 338 U.S. 366 (1949).

Whether a taxpayer's request to have his/her refund directly deposited into a bank account constitutes an assignment of the taxpayer's refund claim within the meaning of the Act will depend upon whether the deposit constitutes a transfer of the taxpayer's legal or equitable rights to the refund to a third party not entitled to the refund. See generally Miller v. Wells Fargo Bank International Corp., 540 F.2d 548 (2d Cir. 1976). The Act provides that an assignment is (1) a transfer of any part of a claim against the United States, (2) the transfer of an interest in the claim or (3) the authorization to receive payment for any part of the claim. 31 U.S.C. § 3727(a). See also, Nickell v. United States, 355 F.2d 73, 76 (10th Cir. 1966) (where the court recognized that to be enforceable in law, an assignment must manifest the intention to assign).

As described above, state law and deposit agreements vary widely. Deposits into some joint accounts do not presumptively vest ownership in all signatories or constitute transfers of ownership to co-signatories. See Chopin, above. However, deposits into some joint accounts do automatically vest ownership in all signatories and constitute transfers of ownership to co-

signatories. See Desrosiers, above. If the Service "direct deposited" a taxpayer's refund into a Desrosiers-type joint account with a signatory not entitled to the refund, the deposit would probably be an assignment of the refund claim subject to the Assignment of Claims Act. Since the assignment would not satisfy the conditions of the Act to bind the government, the Service should not honor the deposit request.

Obviously, it would be inequitable for a taxpayer to request direct deposit and then assert an improper assignment argument against the government. See Bailey v. United States, 109 U.S. 432 (1883). However, despite the equities, a direct deposit transferring ownership of the refund claim to an account signatory not entitled to the refund, remains an improper payment under section 6402 and an ineffective assignment under the Assignment of Claims Act.

If you require any further information on the section 6402 issues, please contact George Blaine, (202) 622-4940. If you would like to discuss the assignment issues, please contact Joseph Clark, (202) 622-3640.

JODY BREWSTER
Assistant Chief Counsel
(Income Tax & Accounting)

JOYCE E. BAUCHNER
Assistant Chief Counsel
(General Litigation)

cc: Pat Dowling CC:M&SP
Judy Dunn CC:DOM
Eliot Fielding CC:EL